Remarks on Financial Regulatory Reform
June 17, 2009

Thank you. Please, everybody, be seated. Thank you very much. Since taking office, my administration has mounted what I think has to be acknowledged as an extraordinary response to a historic economic crisis. But even as we take decisive action to repair the damage to our economy, we're working hard to build a new foundation for sustained economic growth. This will not be easy. We know that this recession is not the result of one failure, but of many. And many of the toughest challenges we face are the product of a cascade of mistakes and missed opportunities which took place over the course of decades.

That's why, as part of this new foundation, we're seeking to build an energy economy that creates new jobs and new businesses to free us from our dependence on foreign oil. We want to foster an education system that instills in each generation the capacity to turn ideas into innovations, and innovations into industries and jobs. And as I discussed on Monday at the American Medical Association, we want to reform our health care system so that we can remain healthy and competitive.

This new foundation also requires strong, vibrant financial markets, operating under transparent, fairly administered rules of the road that protect America's consumers and our economy from the devastating breakdown that we've witnessed in recent years.

It is an indisputable fact that one of the most significant contributors to our economic downturn was a unraveling of major financial institutions and the lack of adequate regulatory structures to prevent abuse and excess. A culture of irresponsibility took root from Wall Street to Washington to Main Street. And a regulatory regime basically crafted in the wake of a 20th century economic crisis—the Great Depression—was overwhelmed by the speed, scope, and sophistication of a 21st century global economy.

In recent years, financial innovators, seeking an edge in the marketplace, produced a huge variety of new and complex financial instruments. And these products, such as asset-based securities, were designed to spread risk, but unfortunately, ended up concentrating risk. Loans were sold to banks, banks packaged these loans into securities, investors bought these securities often with little insight into the risks to which they were exposed. And it was easy money while it lasted. But these schemes were built on a pile of sand. And as the appetite for these products grew, lenders lowered standards to attract new borrowers. Many Americans bought homes and borrowed money without being adequately informed of the terms, and often without accepting the responsibilities.

Meanwhile, executive compensation unmoored from long-term performance, or even reality, rewarded recklessness rather than responsibility. And this wasn't just the failure of individuals; this was a failure of the entire system. The actions of many firms escaped scrutiny. In some cases, the dealings of these institutions were so complex and opaque that few inside or outside these companies understood what was happening. Where there were gaps in the rules, regulators lacked the authority to take action. Where there were overlaps, regulators lacked accountability for their inaction.

An absence of oversight engendered systematic and systemic abuse. Instead of reducing risk, the markets actually magnified risks that were being taken by ordinary families and large firms alike. There was far too much debt and not nearly enough capital in the system. And a growing economy bred complacency.

Now, we all know the result: the bursting of a debt-based bubble; the failure of several of the world's largest financial institutions; the sudden decline in available credit; the deterioration of the economy; the unprecedented intervention of the Federal Government to stabilize the financial markets and prevent a wider collapse; and most importantly, the terrible pain in the lives of ordinary Americans. And there are retirees who've lost much of their life savings, families devastated by job losses, small businesses forced to shut their doors. Millions of Americans who've worked hard and behaved responsibly have seen their life dreams eroded by the irresponsibility of others and by the failure of their Government to provide adequate oversight. Our entire economy has been undermined by that failure.

So the question is, what do we do now? We did not choose how this crisis began, but we do have a choice in the legacy this crisis leaves behind. So, today, my administration is proposing a sweeping overhaul of the financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression.

These proposals reflect intensive consultation with leaders of Congress, including those who are here today: Chairman Dodd and Chairman Frank, who, along with Senator Shelby and Representative Bachus, will be meeting with me throughout this process. They met with me earlier this year to jumpstart the discussion of reform. These reforms are also drawing on conversations with regulators, including those I met with this morning, as well as consumer advocates and business leaders, academic experts, and the broader public.

In these efforts, we seek a careful balance. I've always been a strong believer in the power of the free market. It has been and will remain the engine of America's progress, the source of prosperity that's unrivaled in history. I believe that jobs are best created not by government, but by businesses and entrepreneurs who are willing to take a risk on a good idea. I believe that our role is not to disparage wealth, but to expand its reach; not to stifle the market, but to strengthen its ability to unleash the creativity and innovation that still makes this Nation the envy of the world.

So that's our goal: to restore markets in which we reward hard work and responsibility and innovation, not recklessness and greed; in which honest, vigorous competition is the system—in the system is prized, and those who game the system are thwarted.

With the reforms we're proposing today, we seek to put in place rules that will allow our markets to promote innovation while discouraging abuse. We seek to create a framework in which markets can function freely and fairly, without the fragility in which normal business cycles suddenly bring the risk of financial collapse. We want a system that works for businesses and consumers.

There are those who will say that we do not go far enough, that we should have scrapped the system altogether and started all over again. I think that would be a mistake. Instead, we've crafted reforms to pinpoint the structural weaknesses that allowed for this crisis and to make sure that these problems are dealt with so that we're preventing crises in the future.

And there are also those who say that we are going too far. But the events of the past few years offer ample testimony for the need to make significant changes. The absence of a working regulatory regime over many parts of the financial system, and over the system as a whole, led us to near catastrophe. We shouldn't forget that. We don't want to stifle innovation. But I'm convinced that by setting out clear rules of the road and ensuring transparency and fair dealing, we will actually promote a more vibrant market. This principle is at the heart of the changes we're proposing, so let me list them for you.

First, we're proposing a set of reforms to require regulators to look not only at the safety and soundness of individual institutions but also, for the first time, at the stability of the financial system as a whole.

One of the reasons this crisis could take place is that while many agencies and regulators were responsible for overseeing individual financial firms and their subsidiaries, no one was responsible for protecting the whole system from the kinds of risks that tied these firms to one another. Regulators were charged with seeing the trees, but not the forest. And even then, some firms that posed a so-called systemic risk were not regulated as strongly as others; they behaved like banks but chose to be regulated as insurance companies, or investment firms, or other entities that were under less scrutiny.

As a result, the failure of one firm threatened the viability of many others, and the effect multiplied. There was no system in place that was prepared for this kind of outcome. And more importantly, no one has been charged with preventing it. We were facing one of the largest financial crises in history, and those responsible for oversight were mostly caught off guard and without the authority needed to address the problem.

It's time for that to change. I am proposing that the Federal Reserve be granted new authority, and accountability, for regulating bank holding companies and other large firms that pose a risk to the entire economy in the event of failure. We'll also raise the standard to which these kinds of firms are held. If you can pose a great risk, that means you have a great responsibility. We will require these firms to meet stronger capital and liquidity requirements so that they're more resilient and less likely to fail.

And even as we place the authority to regulate these large firms in the hands of the Federal Reserve, so that lines of responsibility and accountability are clear, we will also create an oversight council to bring together regulators from across markets to coordinate and share information, to identify gaps in regulation, and to tackle issues that don't fit neatly into an organizational chart. We're going to bring everyone together to take a broader view, and a longer view, to solve problems in oversight before they can become crises.

As part of this effort, we're proposing the creation of what's called resolution authority for large and interconnected financial firms so that we're not only putting in place safeguards to prevent the failure of these firms but also a set of orderly procedures that will allow us to protect the economy if such a firm does in fact go underwater.

Think about this: If a bank fails, we have a process through the FDIC that protects depositors and maintains confidence in the banking system. This process was created during the Great Depression when the failure of one bank led to runs on other banks, which in turn threatened wider turmoil. And it works. Yet we don't have any effective system in place to contain the failure of an AIG, or the largest and most interconnected financial firms in our country.

And that's why, when this crisis began, crucial decisions about what would happen to some of the world's biggest companies—companies employing tens of thousands of people and holding trillions of dollars in assets—took place in emergency meetings in the middle of the night. And that's why we've had to rely on taxpayer dollars. We should not be forced to choose between allowing a company to fall into a rapid and chaotic dissolution, or to support the company with taxpayer money. That's an unacceptable choice. There's too much at stake, and we're going to change it.

Second, we're proposing a new and powerful agency charged with one—just one job: looking out for ordinary consumers. And this is essential, for this crisis was not just the result of decisions made by the mightiest of financial firms; it was also the result of decisions made by ordinary Americans to open credit cards and take out home loans and take on other financial obligations. We know that there were many who took out loans they knew they couldn't afford, but there were also millions of Americans who signed contracts they didn't always understand offered by lenders who didn't always tell the truth. Even today, folks sign up for mortgages or student loans or credit cards and face a bewildering array of incomprehensible options. Companies compete not by offering better products, but more complicated ones, with more fine print and more hidden terms.

So this new agency will change that, building on credit card reforms I signed into law a few weeks ago with the help of many of the Members of Congress who are here today. This agency will have the power to set standards so that companies compete by offering innovative products that consumers actually want and actually understand. Consumers will be provided information that is simple, transparent, and accurate. You'll be able to compare products and see what's best for you. The most unfair practices will be banned. Those ridiculous contracts with pages of fine print that no one can figure out—those things will be a thing of the past. And enforcement will be the rule, not the exception.

For example, this agency will be empowered to set new rules for home mortgage lending so that the bad practices that led to the home mortgage crisis will be stamped out. Mortgage brokers will be held to higher standards. Exotic mortgages that hide exploding costs will no longer be the norm. Home mortgage disclosures will be reasonable, clearly written, and concise. And we're going to level the playing field so that nonbanks that offer home loans are held to the same standards as banks that offer similar services, so that lenders aren't competing to lower standards, but rather are competing to meet a higher bar on behalf of consumers.

Now, the mission of this new agency must also be reflected in the work we do throughout the Government. There are other agencies, like the Federal Trade Commission, charged with protecting consumers, and we must ensure that those agencies have the resources and the state-of-the-art tools to stop unfair and deceptive practices as well.

Third, we're proposing a series of changes designed to promote free and fair markets by closing gaps and overlaps in our regulatory system, including gaps that exist not just within but between nations.

We've seen that structural deficiencies allow some companies to shop for the regulator of their choice, and others, like hedge funds, to operate outside of the regulatory system altogether. We've seen the development of financial instruments, like many derivatives, that are so complex as to defy efforts to assess their actual value. And we've seen a system that allowed lenders to profit by providing loans to borrowers who would never repay, because the lender offloaded the loans and the consequences to somebody else.

And that's why, as part of these reforms, we will dismantle the Office of Thrift Supervision and close loopholes that have allowed important institutions to cherry pick among banking rules. We will offer only one Federal banking charter, regulated by a strengthened Federal supervisor. We'll raise capital requirements for all depository institutions. Hedge fund advisers will be required to register with the SEC.

We're also proposing comprehensive regulation of credit default swaps and other derivatives that have threatened the entire financial system. And we will require the originator of a loan to retain an economic interest in that loan, so that the lender, and not just the holder of a security, for example, has an interest in ensuring that a loan is actually paid back. By setting commonsense rules, these kinds of financial instruments can play a constructive, rather than destructive role.

Now, over the past two decades, we've seen time and again cycles of precipitous booms and busts. In each case, millions of people have had their lives profoundly disrupted by developments in the financial system, most severely in our recent crisis. These aren't just numbers on a ledger. This is a child's chance to get an education. This is a family's ability to pay their bills or stay in their homes. This is the right of our seniors to retire with dignity and security and respect. These are American dreams, and we should not accept a system that consistently puts them in danger. Financial institutions have an obligation to put—to themselves and to the public to manage risks carefully. And as President, I have a responsibility to ensure that our financial system works for the economy as a whole.

There's always been a tension between those who place their faith in the invisible hand of the marketplace and those who place more trust in the guiding hand of the Government, and that tension isn't a bad thing. It gives rise to healthy debates and creates a dynamism that makes it possible for us to adapt and grow. For we know that markets are not an unalloyed force for either good or for ill. In many ways, our financial system reflects us. In the aggregate of countless independent decisions, we see the potential for creativity, and the potential for abuse. We see the capacity for innovations that make our economy stronger, and for innovations that exploit our economy's weaknesses.

We are called upon to put in place those reforms that allow our best qualities to flourish, while keeping those worst traits in check. We're called upon to recognize that the free market is the most powerful generative force for our prosperity, but it is not a free license to ignore the consequences of our actions.

This is a difficult time for our Nation. But from this period of challenge, we can once again tap those values and ideals that have allowed us to lead the global economy and will allow us to lead once again. That's how we'll help more Americans live their own dreams. That's why these reforms are so important. And I look forward to working with leaders in Congress and all of you to see these proposals put to work so that we can overcome this crisis and build a lasting foundation for prosperity.

Thank you very much, everybody. Thank you.

NOTE: The President spoke at 12:53 p.m. in the East Room at the White House.

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Locations: Washington, DC.

Names: Bachus, Spencer T., III; Dodd, Christopher J.; Frank, Barney; Shelby, Richard C.

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